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UNCLAS SECTION 01 OF 03 TAIPEI 000498

SIPDIS

STATE PLEASE PASS AIT/W AND USTR

STATE FOR EAP/RSP/TC, EAP/EP AND EB/IFD/OIA

USTR FOR SCOTT KI

USDOC FOR 4420/USFCS/OCEA/EAP/LDROKER
USDOC FOR 3132/USFCS/OIO/EAP/ADAVENPORT
TREASURY FOR OASIA/ZELIKOW AND WISNER
TREASURY PLEASE PASS TO OCC/AMCMAHON
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN

SENSITIVE

E.O. 12958: N/A

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SUBJECT: Revenge of the Budget Cutters

SUMMARY AND COMMENT

¶11. (SBU) Taiwan's Legislative Yuan (LY) passed the government's 2005 central budget during its final session. The opposition Kuomintang (KMT) Party and People First Party (PFP) used their legislative majority to slash funding for some government agencies. The deepest cuts seemed politically motivated. The cuts will slow Taiwan's privatization of state-owned enterprises (SOEs) and efforts to promote research and development. The final LY session was more notable for what it did not do than for what it accomplished since it failed to even consider most pending legislation, including several bills of economic importance such as the creation of a National Communications Commission, re-funding the Financial Reconstruction Fund, and a bill for reorganization of the executive branch. The LY performance in its final session demonstrated again how preoccupation with narrow political issues is blocking progress on Taiwan's national priorities. END SUMMARY AND COMMENT.

Day Late, Dollar Short

¶12. (SBU) The LY passed the 2005 central government budget just before midnight January 20, 2005 during a marathon final session that lasted 28 hours. The approved budget slashed the Chen Administration's 2005 funding request by nearly 5% (NT\$71.6 billion (US\$2.2 billion)) to NT\$1,402.7 billion and cut spending by a little under 2% (NT\$27.2 billion to NT\$1,625.6 billion). It was the biggest cut in the central government budget in three years and will increase Taiwan's 2005 budget deficit to NT\$277.3 billion, more than had been projected in the Administration's budget proposal, but still less than the 2004 deficit. The 2005 fiscal deficit, which includes the budget deficit plus debt repayment, will reach NT\$336.1 billion.

¶13. (SBU) Taiwan's Budget Bureau section chief Lin Shuen-yu told AIT/T the deficit would be financed by NT\$255 billion of bonds with the remaining NT\$81.1 billion coming from past government savings. Lin estimated that outstanding debt would reach NT\$3,668 billion or 35.7% of GNP by the end of 2005, a lower percentage than found in most developed nations and much lower than Singapore's 112% or Japan's whopping 169%, although higher than South Korea's 21%.

Retaliation Against Key Agencies

¶13. (SBU) Local media speculated that the funding cuts were retaliation by the opposition parties against government agencies that acted contrary to the opposition party interests. Reports noted that the Government Information Office (GIO) fought to take broadcast channels away from the KMT-owned Broadcasting Corporation of China, and was punished with the deepest budget cut, nearly 13% less than the requested funding level. GIO Director General Lin Chia-lung's representational fund was totally removed and funding for legalization of underground broadcasting stations (which would acquire frequencies taken back from the Broadcasting Corporation of China) was cut in half. The LY also cut by half funding for GIO public interest programs, which broadcast numerous pro-administration reports during the March 20, 2004 presidential election campaign. Proposed funding of NT\$12 million for the GIO's press release and coordination program, which also distributed pro-administration political material, was cut by 95% to only NT\$0.6 million.

14. (SBU) The opposition-controlled LY also slashed the budget for operations controlled by the Education Minister Du Chen-sheng and National Physical Fitness Council Chairman Chen Chuan-shou. Opposition KMT/PFP parties were reportedly upset with these officials' strong support of the ruling party and their efforts to promote local Taiwan history and geography in school textbooks. The judiciary was also apparently targeted for partisan reasons. In December 2004 Taiwan's high court ruled that the committee formed by the LY to investigate the election-eve shooting of President Chen Shui-bian and Vice President Annette Lu was unconstitutional. Local media saw it as retaliation that the LY stopped all funding for allowances and overseas trips for all of the high court's justices.

Economic Impact

15. (SBU) The LY approved budget cut by 20% funding for Ministry of Economic Affairs (MOEA) efforts to promote private research and development activities. The cut will prevent research and development spending from reaching the announced target of 3% of GDP by 2008. Other cuts included total elimination of revenues from sales of equity shares in state-owned enterprises, removing the legal basis for the privatization programs being conducted by the MOEA and MOF. The LY also passed a resolution to block increases in national health insurance premiums without express consent of the LY, a move that will make it more difficult to resolve the national health insurance system's financial problems.

COMMENT

16. (SBU) The 2005 budget, and the hundreds of bills not even addressed by the LY, signal continued political gridlock over national economic priorities. Longstanding efforts to address pressing economic issues - financial sector reform, privatization and R&D policy - have once again been set aside as the major political parties jockey for position. While the Administration has put in place a new financial supervisory system, it has failed to secure funding to deal with the several banks already taken over by bank regulators and additional banks and credit coops that are very weak. Taiwan's stuttering steps towards WTO-mandated privatization of state-owned enterprises have again been blocked. In addition, Taiwan's Department of Health will find it more difficult to address the deficit spending of the national health insurance program. These are further another examples of politics impeding the implementation of already established policy. The inability of the government to pursue a coherent macro economic strategy will have negative consequences for Taiwan's long-term economic health. The increased budget deficit and the consequent rise in interest rates will have a negative effect on the competitiveness of Taiwan firms.

PAAL